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SUBJECT: LESOTHO: 2008 INVESTMENT CLIMATE STATEMENT

REF: STATE 158802

MASERU 00000029 001.2 OF 005

¶1. SUMMARY: Embassy Maseru submits the following information for Lesotho's 2008 Investment Climate Statement. The Kingdom of Lesotho is open to foreign direct investment (FDI) and generally treats foreign investors favorably. With most investment originating from East Asia, FDI in Lesotho is primarily channeled into export-oriented manufacturing, specifically textiles and garments for the U.S. market. Lesotho's investment climate is favorable with regard to currency conversion, monetary transfer policies, and a lack of undue burdens on investors. The primary weaknesses of the investment climate are its underdeveloped legal framework for investors and the need for land reform. Overall, Lesotho has maintained an inviting posture with regards to FDI, and remains "open for business."
END SUMMARY.

A.1. Openness to Foreign Investment

¶2. Lesotho is open to foreign direct investment (FDI) and generally treats foreign investors favorably. However, Lesotho's legal framework with regards to FDI is not well developed, and thus problems exist with regards to transparency and consistent application of the law. Lesotho has found success in attracting FDI to its export sector, and foreign investors in the apparel industry have created new jobs and contributed to poverty reduction. Current business taxation and regulation provisions only partially address investor needs, and the Government of Lesotho (GOL) is under pressure to update relevant laws affecting investors in various sectors.

¶3. Ninety percent of FDI in Lesotho flows into export-oriented manufacturing, a sector stimulated largely by the U.S. African Growth and Opportunity Act (AGOA). This FDI created an apparel sector which now provides approximately 40,000 jobs. The single largest investment is believed to the US\$90 million capital infrastructure investment of Nien Hsing Group in Taiwan. Foreign firms in Lesotho concentrate their production on a narrow range of products, such as knit apparel and blue jeans. Foreign companies also invested smaller amounts in footwear manufacturing, electronics components assembly, food processing, and miscellaneous small-scale manufacturing.

¶4. Lesotho's telecommunications sector has attracted considerable FDI. An international consortium composed of ESKOM Zimbabwe's Econet Wireless International and Mauritius Telecom now own 70% of Telecom Lesotho. Lesotho has a relatively high penetration of telephone connectivity relative to its low per

capita income. Communications services have been extensively modernized and expanded over recent years, although significant portions of mountainous rural Lesotho remain without such services.

15. FDI in air transportation has not been successful. The parastatal Lesotho Airways closed in 1997 due to its inability to attract FDI. Air routes to and from Maseru are now handled exclusively by South African Airways. Foreign investors have not pled significant capital in the tourism sector, including activities aimed at protecting the natural environment and ecological attractions.

16. FDI in the mining sector has experienced a recent revival through the opening of Lets'eng Diamonds, a partnership between a South African-owned company and the Lesotho Government. The mine employs about 50 people, most of whom are Lesotho nationals. A European mining company and the GOL jointly operate another mine in Liqhobong, as well as the Kao kimberlite pipe in Butha Buthe District. South African companies are currently prospecting the Kolo mine in southern Lesotho. In its attempt to attract FDI in the mining sector, the GOL offered a number of concessions to foreign investors including VAT exemptions on inputs used during construction and withholding tax exemptions on dividends and interests payments. In return, the Government of Lesotho is granted an eight percent royalty on gross diamond sales, a 12.5% equity interest in joint ventures with foreign companies, and a 12.5% share of dividends. Major diamond finds in 2006 and 2007 generated worldwide media coverage.

The Origin of Foreign Investors

17. Lesotho's apparel sector is entirely East Asian and South African-owned, and currently employs approximately 40,000 people. Two factories are under Taiwanese ownership, two are owned by Hong Kong concerns, one is Singapore-owned, and eight are owned by South African firms. The rest of the approximately 19 factories are owned by PRC investors. None are under local

MASERU 00000029 002.2 OF 005

ownership. South African FDI is present in footwear factories, four electronics firms, the Sun Hotel chain, air transportation, insurance, telecommunications, financial services, and mining. FDI from other countries includes Canadian mining interests and U.S. and Chinese investment in food processing industries.

18. Lesotho's success in attracting FDI has been limited largely to export-oriented manufacturing. No foreign ownership at any level, including positions on boards of directors, is permitted in reserved trading license businesses (i.e., small scale retail and services operations). The restrictions on foreign involvement in small scale services provision and manufacturing are perceived as instruments of immigration control, as there is a great deal of political sensitivity regarding small business owners from Asia. Many trading businesses and all medium to large manufacturing businesses are open to FDI. Nevertheless, a relevant trading or industry license is required and must be renewed annually.

19. Generally, foreign investors are treated equally with domestic investors. One significant exception is a prohibition on foreigners holding land lease titles (land may not be purchased in Lesotho, as all land is officially owned by the crown). Lesotho has no legal provisions discriminating among various FDI source countries. Lesotho's membership in SADC does not lead to preferential treatment for investors from other SADC countries. Lesotho's standards of foreign investment protection are good in practice, but the legal framework guaranteeing these norms is weak. For example, there is no foreign investment law, and Bilateral Investment Treaties (BITs) have been concluded with only two countries -- the United Kingdom (1981) and Germany (1985).

A.2. Conversion and Transfer Policies

¶10. Lesotho uses traditional foreign exchange controls, though its participation in the Southern Africa Common Monetary Area (CMA) restricts the independence of its monetary policy. The CMA includes Lesotho, Namibia, South Africa, and Swaziland. Under the CMA, the South African rand, alongside the Lesotho loti, is legal tender in Lesotho. Under CMA rules, the loti should be exchanged at a one/one ratio with the rand, and the rand/loti peg must be maintained with reserves in rand and other foreign exchange. There are no exchange controls between Lesotho and South Africa, but CMA members agree to enforce exchange controls with third parties.

¶11. The Government of Lesotho delegates authority to commercial banks to undertake current account transactions, and Lesotho has acceded to Article VIII of the International Monetary Fund. However, dividend payments still require the Central Bank approval. The Central Bank of Lesotho (CBL) maintains direct powers of approval over foreign exchange requirements for all capital account transactions including FDI, capital disinvestment, and contracting and servicing offshore debt. There has never been a case of CBL blockage of such transfers. Lesotho is a member of the Southern African Common Policy on approval of foreign loans. However, policies on foreign borrowing are not strongly developed as there is insufficient foreign borrowing by resident businesses.

A.3. Expropriation and Compensation

¶12. Lesotho's constitution states that the acquisition of private property by the state can only occur for specified public purposes and in exchange for full and prompt compensation. Any party subject to such expropriation has the right to appeal the action or the compensation offered to the nation's High Court. The constitution does not address whether compensation may be paid abroad in the case of a non-resident. Under existing constitutional provisions, several mining companies filed a case against the Lesotho Water Highlands Project and its financiers alleging that their mineral lease rights were unlawfully expropriated without compensation when a new dam flooded a potential mining area. Lesotho's courts found in favor of the Lesotho Highlands Water Project and its financiers, stating that all proper regulations and notifications were followed prior to the dam construction.

A.4. Dispute Settlement

¶13. Foreign investors have full and equal recourse to Lesotho's

MASERU 00000029 003.2 OF 005

courts to settle commercial and labor disputes. The nation's courts are regarded as fair and impartial in cases involving foreign investors. In complex commercial cases, overseas judges may be invited to the bench. Under Lesotho's BIT agreement with United Kingdom, an investor may take a dispute with the Government of Lesotho to international arbitration, but the BIT agreement with Germany does not address this issue. Lesotho is member of the Multilateral Investment Guarantee Agency (MIGA) and has acceded to the Convention on Settlement of Investment Disputes between States and Nationals of Other States.

A.5. Performance Requirements

¶14. There are no blanket incentives specifically for all foreign investors and no performance requirements imposed exclusively on foreign investors as a condition of investment. The principal business taxes in Lesotho are income tax, customs, excise duties, and value added tax. Corporate income taxes heavily favor investment in manufacturing, as income is taxed at

zero percent and there is no withholding tax on dividends paid to non-residents. Income in all other sectors is taxed at 35%, and there is a further 25% withholding tax on non-resident dividends. Moreover, only industrial buildings qualify for depreciation allowances. Buildings for services, tourism, and farming are not depreciable. Also, infrastructure such as land improvements and site services do not qualify.

A.6. Right to Private Ownership and Establishment

¶15. Foreign entities have the right to establish enterprises in Lesotho, but many types of new businesses require specialized licenses (see section A.8. below). Lesotho has no competition law or overall competition regulator. Instead, under the industrial and trading licensing system, a business can apply for protection from competition for up to 10 years.

A.7. Protection of Property Rights

¶16. Lesotho generally respects international intellectual property laws and is a member of the World Intellectual Property Organization (WIPO) and the African Intellectual Property Organization (AIPO). Patents are rarely issued in Lesotho, but trademark protection is often sought and granted. Intellectual property protection is regulated by Industrial Property Order and the Copyright Act of 1989. The law protects patents, industrial designs, trademarks, and copyrights. There is no apparent enforcement of intellectual property laws with regards to copyrighted music or films.

A.8. Transparency of the Regulatory System

¶17. The judicial system is fair and competent in commercial matters. The government is willing to supplement the bench with foreign judges in cases requiring specialized expertise. Generally, there is adequate regard for contracts with foreign parties and equal treatment of foreign investors before the courts in disputes with national parties or the government.

¶18. Corporate law is based on the Companies Act of 1967 which provides reasonable standards for corporate behavior. However, it has been criticized as both incomplete and overly complex. Technical improvements were incorporated in a 1998 draft of a revised law, though it was never passed by parliament.

¶19. The regulatory framework for utilities is modern, while many analysts judge mining regulations to be outdated. Lesotho's current mining legislation gives the authority to grant land rights to the King and traditional chiefs upon the recommendation of a Mining Board, rather than to a government ministry. Financial services regulation is sufficient. However, the industrial and trading license system, which requires licenses for 44 types of business, long ago lost its original purpose of protecting new firms from competition. Some enterprises can require up to four licenses for legal operation.

¶20. The Lesotho Telecommunications Authority (LTA) acts as an independent regulator of the telecom industry. The LTA sets the conditions for the entry of new competitive operators, although it maintains Lesotho Telecom's monopoly on fixed line and international services.

MASERU 00000029 004.2 OF 005

¶21. Current banking regulations do not grant the Central Bank of Lesotho power to direct interest rates, exchange rates, margins, or the range of services offered by banks operating in Lesotho. This is due to the currency peg with the South African rand, which both relinquishes Lesotho's leverage with regards to monetary policy and creates a lower political risk environment

for banking investment.

A.9. Efficient Capital Markets and Portfolio Investment

¶22. Lesotho hosts three foreign-owned banks: First National Bank, Ned Bank, and Standard Bank (the latter bought a 70% share in state-owned Lesotho Bank). The financial base of these banks are sound, as they are supported by a large foundation of foreign-based capital. Judgments as to the market-orientation of credit provision by these banks are difficult as very little credit is extended to local consumers. Industrial and commercial credit is provided by the parastatal Lesotho National Development Corporation (LNDC). The LNDC's mandate is to promote and facilitate foreign investment.

A.10. Political Violence

¶23. Rioting and violence associated with an attempted coup d'etat in 1998 still cast a shadow over today's investment environment. The country has made considerable strides in the intervening decade to consolidate and strengthen democracy, but there is room for improving investors' confidence. Following a free and peaceful February 2007 general election, Lesotho experienced several civil disturbances and general strikes associated with a political impasse over the allocation of parliamentary seats. In the wake of June 2007 attacks by unknown gunmen on the residences of prominent government and political leaders, the Government of Lesotho imposed a two week long dusk until dawn curfew in Maseru. Political tensions between governing and opposition parties continue, but the national political atmosphere is generally calm.

A.11. Corruption

¶24. Investors reported that corruption is not a significant factor affecting their investments. Anti-corruption legislation passed in 1999 was implemented through the creation of an autonomous anti-corruption unit, the Directorate on Crime and Economic Offenses (DCEO). The Government of Lesotho actively prosecutes corruption cases at various levels of authority, including cases against the former Principal Secretary of Justice and Constitutional Affairs, a former Deputy Commissioner of Police, and various foreign and domestic parties engaged in the Lesotho Highlands Water Project.

A.13. OPIC Insurance Program

¶25. The Overseas Private Investment Corporation (OPIC) insured one American investment in Lesotho, Seaboard Corporation's joint venture with Lesotho Flour Mills, which began operations in 1998 and currently employs approximately three-hundred people. This is OPIC's sole current activity in Lesotho.

A.14. Labor

¶26. Lesotho's employers operate under the Labor Code Order of 1992 which regulates terms of employment and requirements for worker health, safety, and welfare. It was amended in 2004 to address HIV/AIDS policies in the workplace. Unionization is permitted. The law created an independent Directorate of Industrial Dispute Prevention and Resolution. Statutory minimum wages are set annually by the Ministry of Labor and Employment in accordance with recommendations from a Wages Advisory Board including worker, management, and government representatives. In 2001, Lesotho ratified ILO Convention 182 on the Prohibition and Elimination of the Worst Forms of Child Labor and Convention 138 on Minimum Age of Employment.

¶27. The Labor Code Order of 1992 requires every non-citizen employee or self-employed person to have a valid work permit. A work permit is issued by the Labor Commissioner who, by

MASERU 00000029 005.2 OF 005

regulation, must be satisfied that no qualified Lesotho citizen is available for the position. The statutory maximum duration of a work permit is two years.

A.16. Foreign Direct Investment Statistics

¶28. Lesotho's FDI statistics since 2000 are estimated as follows:

Year	2000	2001	2002	2003
FDI Stock in M Maloti	218.3	242.91	282.72	316.61
FDI Stock in M of \$	31.18	34.7	40.38	45.23
FDI as % of GDP	0.03	0.04	0.07	0.05
GDP Purchasers' Prices in M of \$	986.66	863.33	603.5	982.625

Year	2004	2005	2006	2007
FDI Stock in M Maloti	343.68	364.37	623.00	745.03
FDI Stock in M of \$	49.09	52.05	89.00	106.43
FDI as % of GDP	0.03	0.04	0.06	0.07
GDP Purchasers' Prices in M of \$	1419.85	1438.94	1445.71	1481.89

Source: FDI Stock data from the Central Bank of Lesotho, GDP data from the Bureau of Statistics Website (National Accounts)

¶29. Lesotho's FDI data is incomplete and does not currently meet the needs of policy makers. The Central Bank estimates FDI using information received from Lesotho National Development Corporation (LNDC) and, as such, the data sometimes include planned (not actual) projects, leading to possible overestimation. This data does not capture the reinvestment element of FDI inflows. By confining this data to initial equity investments, the figures ignore later investments financed by retained earnings from foreign companies already in Lesotho. This could also lead to an underestimation of FDI volume.

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